Internal Revenue Service

memorandum

CC:TL-N-280-90
Br1:HFRogers

date: NOV 16 1989

to: District Counsel, Miami CC:MIA

from: Assistant Chief Counsel (Tax Litigation) CC:TL

---

subject: The National Office's position on closing agreements in defective QTIP elections

This is in response to your request for tax litigation advice dated October 4, 1989.

ISSUE

Under what circumstances should closing agreements be entered into when the estate makes a defective I.R.C. § 2056(b)(7) election. 2056-0100.

CONCLUSION

For estates which properly used the 1982, 1984 or 1985 versions of Form 706, if a deduction is taken on Schedule M for the value of property that would otherwise qualify as qualified terminable interest property (QTIP) and the amount deducted is consistent with an I.R.C. § 2056(b)(7) election, a closing agreement should be entered into and the deduction should be allowed. This is the case even if the "No" box is checked with regard to the QTIP election question on the return and the property or value of property listed on Schedule M is not specifically identified as QTIP property.

For estates which used the 1987 or later versions of Form 706, if the property is listed as QTIP property, but the election box is not checked, the closing agreement procedure should be extended to them. If the election box is checked, but the property is not listed, the closing agreement procedure should not be available to them.

09200

FACTS

The request for tax litigation advice states that varying treatment is being offered to taxpayers who improperly or incompletely filled out Form 706 with respect to the section 2056(b)(7) election. The request asks that the National Office delineate those situations in which the closing agreement is appropriate.

DISCUSSION

I.R.C. § 2001 imposes a tax on the transfer of the taxable estate of every decedent who is a citizen or resident of the United States. Section 2051 states that the value of the taxable estate shall be determined by deducting from the value of the gross estate [determined in accordance with section 2031] the deductions provided for in this part.

One of the deductions which reduces the gross estate is bequests to a surviving spouse. Section 2056. Section 2056(a) provides that "the value of the taxable estate shall, except as limited by subsection (b), be determined by deducting from the value of the gross estate an amount equal to the value of any interest in property which passes or has passed from the decedent to his surviving spouse." Section 2056(b) limits this deduction in the case of life estates or other terminable interests.

Section 2056(b)(7) allows an estate tax marital deduction for an otherwise nondeductible interest if the surviving spouse receives a "qualifying income interest for life" in the property and the executor elects to treat the property as "qualified terminable interest property." Section 2056(b)(7) provides that the election "shall be made by the executor on the return of tax imposed by section 2001." Generally, if an election is made under section 2056(b)(7), then the property subject to the election is includible in the gross estate of the surviving spouse under section 2044.

In order to make the election on the June 1982, January 1984 and March 1985 versions of Form 706, the return preparer is instructed to mark the "Yes" box opposite the question on the return asking if QTIP treatment is being elected. In addition, the return preparer is instructed to identify the assets subject to the election on Schedule M as QTIP property.

During 1985, it became apparent that numerous return preparers had not fully complied with the requirements for making a QTIP election. One of the problems appeared to be the manner in which the election question was phrased on the 1982 and 1984 revisions of Form 706. During June 1985, Commissioner Egger and Chief Counsel Goldberg determined that the National Office would direct the field offices to enter into closing agreements with

the taxpayer/estates, pursuant to which the marital deduction would be allowed.

Although the 1985 version of Form 706 had been revised to eliminate any ambiguity in the QTIP election question, it became apparent that numerous returns preparers continued to make defective elections either by checking "No" with respect to the election question and/or by failing to identify the basis for the deduction on Schedule M. During the summer of 1988, the National Office determined that use of the closing agreement procedure to resolve cases involving the 1985 return was appropriate. It was further determined that the standard for relief applied to the 1982 and 1984 versions of Form 706 should also be applied to the 1985 version.

It has been determined that the closing agreement procedure should be made available with respect to the 1982, 1984, and 1985 versions of Form 706 where a return preparer either checked "No" to the QTIP election or left the election blank and a deduction was taken on Schedule M for the value of property that would otherwise qualify as qualified terminable interest property and the amount deducted is consistent with the QTIP election. The closing agreement procedure should be offered even where the property or value of property listed on Schedule M was not identified as QTIP property. In cases where the "Yes" box was checked, but no property or value of property was listed on Schedule M, the closing agreement procedure should not be made available.

These criteria should be applied regardless of the Tax Court's opinion in Estate of Higgins v. Commissioner, 91 T.C. 61 (1988), on appeal, No. 89-1498 (6th Cir.). In Estate of Higgins, the Tax Court held that in order for an estate to qualify for the marital deduction under section 2056(b)(7), the return and the attached schedules must evidence "an unequivocal manifestation of an affirmative intent to make the election of QTIP treatment." 91 T.C. at 70. In Estate of Higgins, the return preparer checked the "No" box in response to the QTIP election question. On Schedule M, the estate deducted the value of the spouse's life estate in a residuary trust (rather than the entire value of the residuary trust which would be the amount properly deductible under section 2056(b)(7)). The court concluded that there was no clear manifestation on the return that QTIP treatment had been elected and determined that the estate had not effectively elected QTIP treatment.

We believe that Estate of Higgins is distinguishable from those situations in which closing agreements should be offered and that the taxpayer's appeal should continue to be defended because the estate included an interest in property on Schedule M which was inconsistent with a section 2056(b)(7) election. However, it was determined that, despite the decision in Estate

of Higgins, the criteria to be used in determining if a closing agreement should be offered in cases involving the 1982, 1984 and 1985 versions of Form 706 would not be amended.

We are aware that this position may cause some return preparers to deliberately make defective QTIP elections and then determine at the time of the audit whether it is more beneficial to take the deduction or to acquiesce in the disallowance of the deduction. This is similar to what occurred in Estate of Howard v. Commissioner, 91 T.C. 329 (1988), on appeal, No. 89-70196 (9th Cir.), where the estate validly made the QTIP election and deducted the value of the property subject to the election. The surviving spouse died shortly thereafter so that it would have been more advantageous not to have made the QTIP election. The estate argued and prevailed in Tax Court that certain technical requirements for QTIP treatment had not been met and that the marital deduction was improper. We believe that, if this aggressive stance occurs at all, it will be very infrequent and that concerns about its occurrence should not prevent criteria from being established for entering into closing agreements.

The request indicates that your office has some concerns about whether the property will be included in the estate of the surviving spouse after a closing agreement is entered into. Because the closing agreement is entered into with the surviving spouse, we believe that any court would view a later action by the surviving spouse's estate to deny the validity of the closing agreement unfavorably. We also believe that the language of section 2044 mandates the inclusion in the surviving spouse's estate of property for which a deduction under section 2056(b)(7) was allowed for the estate of the first spouse to die. Therefore, we view closing agreements as proper when the above criteria are met.

However, the November 1987 version of Form 706 has been significantly revised to accomodate the QTIP election. There is now one box to check to signify the election and a separate schedule is provided for listing the property subject to the election. The criteria to be followed in determining whether to make the closing agreement procedure available in cases involving the 1987 version of Form 706 have, therefore, been tightened. Closing agreements should be made available if the property is listed on Part 2 of Schedule M but the box is not checked. Closing agreements should also be made available where the box is checked but the property is listed on Part 1 of Schedule M. In cases where the box is checked, but no property is listed on Schedule M, the closing agreement procedure should not be made available.

If you have any further questions or comments, please contact Helen F. Rogers of this office at FTS 566-3442.

MARLENE GROSS

By: Richard L. Carlisle
RICHARD L. CARLISLE
Senior Technician Reviewer
Branch 1
Tax Litigation Division